***United States Court of Appeals***

***for the Second Circuit***


# APPELLEE'S BRIEF

75-7096

IN THE

# United States Court of Appeals

## For the Second Circuit

SAMUEL H. SLOAN,

*Plaintiff-Appellant,*

*—against—*

CANADIAN JAVELIN, LTD., *et al.*,

*Defendants-Appellees.*

## BRIEF OF DEFENDANTS-APPELLEES


PATTERSON, BELKNAP & WEBB
*Attorneys for Dow Jones & Company Inc., Stewart Pinkerton*
30 Rockefeller Plaza
New York, New York 10020
(212) 541-4000

*Of Counsel*
MARGUERITE B. FILSON

STROOCK & STROOCK & LAVAN
*Attorneys for Loeb, Rhoades & Co.*
61 Broadway
New York, New York 10004
(212) 425-5200

*Of Counsel*
LAWRENCE WANDELSMAN

SULLIVAN & CROMWELL
*Attorneys for Bache & Co., Inc., The Miami Herald*
48 Wall Street
New York, New York 10005
(212) 952-8100

*Of Counsel*
MARVIN SCHWARTZ
PAMELA S. DWYER

LEONARD TOBOROFF, Esq.
*Attorneys for Chartered New England Corp., F.S. Moseley Estabrook, Inc.*
17 East 63rd Street
New York, New York 10021
(212) 838-2323

*Of Counsel*
MICHAEL SHANNON

DELSON & GORDON
*Attorneys for Edwards & Hanly, Arthur Foote, Robert Della, Raymond Aronson*
230 Park Avenue
New York, New York 10017
(212) 686-8030

*Of Counsel*
EVAN L. GORDON

LORD, DAY & LORD
*Attorneys for American Stock Exchange, Stephen L. Gerard*
25 Broadway
New York, New York 10004
(212) 344-8480

OLITT, FRIEDBERG & KAGEL
*Attorneys for Miller & Co.*
200 Park Avenue
New York, New York 10017
(212) 661-8686

SATTERLEE & STEPHENS
*Attorneys for Watts, Griffis & McQuad*
277 Park Avenue
New York, New York 10017
(212) 826-6200

SILBERFELD, DANZIGER & BANGSER
*Attorneys for Miller Freeman Publications, Inc.*
230 Park Avenue
New York, New York 10017
(212) 889-8400

## CONTENTS

## TABLE OF AUTHORITIES

A. CASES:

IN THE

# United States Court of Appeals

**For the Second Circuit**

**No. 75-7096**

—o—

SAMUEL H. SLOAN,

*Plaintiff-Appellant,*

*—against—*

CANADIAN JAVELIN, LTD., *et al.*,

*Defendants-Appellees.*

—o—

## BRIEF OF DEFENDANTS-APPELLEES

### Statement of the Case

In this appeal the appellant, Samuel Sloan, seeks reversal of the District Court's dismissal of a catch-all securities fraud action brought by him against the forty-eight defendants named in this lawsuit. On May 30, 1974, the Honorable Dudley B. Bonsal dismissed without prejudice Sloan's complaint against the primary defendants, Canadian Javelin, Ltd. (CJV), and its principal officers, (SA-18).* As to the forty-five other named defendants, the Court below ruled that the untimely filing of an "amended complaint" which failed to state a claim as to these defendants was justification for dismissal with prejudice (SA-18). This brief, seeking affirmance of the judg-

* The Supplemental Appendix is cited herein as "SA".

ment below, is submitted jointly on behalf of several of those peripheral defendants.*

An essential question before this tribunal involves the degree of latitude and indulgence to be afforded a *pro se* litigant. In our view Sloan has been afforded far more than the "day" in court to which he is entitled.

## The Facts

Sloan's first complaint (73 Civ. 3801) was filed on September 4, 1973 (A-1—A-2).** Naming Canadian Javelin, Ltd. (CJV), its two principal officers and six other defendants and seeking "actual and punitive damages" in the amount of $150,000, Sloan purports to allege violations of the Securities and Exchange Act of 1934. The complaint alleges that the defendants disseminated or participated in disseminating false and fraudulent information about CJV, thereby misleading the investing public and causing an artificial rise in the price of CJV on the American Stock Exchange. This complaint lacks even the basic jurisdictional allegations and is seriously and severely deficient in other respects. Three defendants made motions to dismiss the complaint for, *inter alia,* failure to state a claim (A-3—A-7, A-18—A-19) and two answers were filed, each seeking a judgment of dismissal on the same grounds (A-8—A-11).

---

* The appellees joining in this brief are:

| | |
|---|---|
| Bache & Co., Inc. | Edwards & Hanly |
| Dow Jones & Company, Inc. | Chartered New England Corp. |
| Stewart Pinkerton | Stephen L. Gerard |
| Arthur Foote | Pickands, Mather & Co. |
| Robert Della | F. S. Moseley Estabrook, Inc. |
| Raymond Aronson | Wood, Walker & Co. |
| Watts, Griffis & McQuad | Loeb Rhoades & Co. |
| The Miami Herald | Muller & Co. |
| American Stock Exchange | Miller Freeman Publications, Inc. |

** The Appendix is cited herein as "A".



Before October 23, 1973, the return date of the motions, Sloan, apparently recognizing the deficiencies of his first complaint, sought to cure them, not by amendment but by filing a second complaint (73 Civ. 4403) (A-14—A-17). In the second complaint, filed October 12, 1973, Sloan includes eight of the original nine defendants and some twenty-four others. This complaint contains twenty paragraphs and purports to be brought under "Rules 10(b) and 10(b)-5 and other rules of the Securities and Exchange Commission and under Section 10(b) and other sections of the Securities Exchange Act of 1934 and sections of the Securities Act of 1933." (A-14). The essential allegations of this complaint are that CJV "employed a wide variety of fraudulent means to cause an artificial rise in the price of its stock;" that CJV "has a long history of fraud and deception over the course of its 22 year history;" (A-14) that "defendant American Stock Exchange has given its official sanction to these fraudulent . . . practices by allowing Javelin to trade . . .;" (A-15) and that other defendants disseminated or played a part in disseminating false or misleading information about CJV to the investing public (A15-16). The sixteen stock brokerage firms through whom unspecified purchases, sales and borrowings of CJV shares were alleged to have been effected are also named as defendants although no fraudulent acts or practices are attempted to be alleged as against them. It is not, for example, alleged that Sloan purchased or sold any shares of CJV in connection with the alleged unspecified fraud or that he purchased or sold in reliance on any of the alleged misstatements claimed to have been disseminated by the defendants. Without specifying how he was damaged, Sloan requested judgment, this time in the amount of $170,000.

At the October 23, 1973 hearing on the motions to dismiss the first complaint, Sloan announced that he was pre-

paring a third complaint which he believed would be sufficient, and Judge Bonsal indicated that the pending motions would be held in abeyance to permit Sloan to prepare an adequate pleading.

On or about November 7, 1973, the defendants were served with an "Amended Complaint" (SA-20—SA-36) bearing both Civil Action numbers, *i.e.* 73 Civ. 3801 and 73 Civ. 4403. Again naming thirty-two defendants,* this third complaint, which was never filed, contains forty-one discursive paragraphs and seeks, in addition to the previously sought $170,000 alleged to have been lost as a result of "trading" in CJV, $2,000,000 in damages "for loss of business, loss of credit rating, harrassment by the various defendants, the F.B.I. and the S.E.C. and by other events described in this complaint." (SA-35, ¶ 41). "Punitive damages" of $5,000,000 are also claimed "in view of the long and notorious history of securities fraud involving Javelin and other defendants and the likelihood that this fraud will be repeated." (SA-35, ¶ 41). After discussing the "history" of CJV and its officers going back to the early 1950's, this third complaint tells a tale of allegedly false and misleading press releases concerning a mining concession in Panama which information was allegedly disseminated or otherwise utilized by the other defendants. Sloan, for the first time, alleges that at the time of the sought to be alleged fraud, he "held a substantial short position in Javelin." (SA-27, ¶ 21).

By this time, the bombardment of Sloan complaints had generated considerable procedural confusion. Answers

---

* The defendants in the "amended complaint" are the same as those named in the second complaint of October 12, 1973 except that one Peter LaRush is substituted for Brig. General Omar Torrejos, President of Panama, named in the earlier complaint.

were filed and motions to dismiss were being made addressed to one, another, several or all of the three complaints.

On November 19, 1973, Judge Bonsal heard oral argument with respect to several of the then outstanding motions to dismiss. The plaintiff appeared and addressed the Court. The defendants' motions to dismiss were denied without prejudice to renewal, and Sloan was granted permission to amend his complaint yet again and was directed to file and serve such amended complaint within twenty days, *i.e.* on or before December 10, 1973. (SA-9).

Disregarding the Court's order, Sloan did not meet the twenty-day deadline and several of the motions to dismiss were renewed.

Nineteen days after his final amended complaint was due, Sloan filed the fourth complaint on December 29, 1973.* Immediately thereafter,** and apparently without much concern about any pending motions, the possibility of renewed motions, or the likelihood of additional motions which might be addressed to his latest attempt to frame a complaint, Sloan proceeded to take a six-week vacation in Europe leaving the numerous defendants and the Court to grapple with the morass of confusion created by him in this lawsuit. (Appellant's Brief p. 12.)

Sloan's untimely fourth complaint (A-69—A-118) names sixteen additional defendants for a grand total of forty-eight, alleges trading losses in the amount of $45,000 (A-117,

---

* On November 19, Sloan was ordered to file *and* serve his final amended complaint within 20 days (SA-9). The defendants were not served until various dates in January, 1974 ranging from 28 to 50 days after the Court had required such service to be effected.

** Sloan left for Iceland on December 29, 1973, the same day that he filed the fourth complaint. (Appellant's Brief p. 24).

¶249), and requests $18,000 from certain broker defendants for an alleged conversion (A-117, ¶252), "declaratory judgment" in the amount of $125,000 (A-118), as well as $2,000,000 for "loss of business" and "harassment" (A-117, ¶250) and $5,000,000 in punitive damages "in view of the history of securities fraud involving Javelin and other defendants." (A-117, ¶251.)

This voluminous 43-page complaint containing ten counts and consisting of 253 separately numbered paragraphs was carefully considered and detailed at length by Judge Bonsal. A description of each of the counts is set fourth in the opinion below (SA-4-6). Although Sloan's allegations are lengthy and the alleged false statements, press releases and manipulative activities of certain defendants are set forth in great detail, the complaint does not indicate any direct injury to the plaintiff and utterly fails to specify fraud on the part of the defendants who have joined in the submission of this brief.

Indeed, it would appear from Sloan's own admission that this "final" complaint is nothing more than a blunderbuss attempt to reach a deep pocket, almost anyone's deep pocket, to compensate him for his speculation losses. For example, Sloan claims to be without funds and has stated openly that he firmly believes the principal culprits (CJV, Doyle and Wismer), as to whom his action has not been extinguished, also to be judgment proof. (A-186.) In the tortured reasoning which characterizes his arguments, Sloan states that the named brokerage defendants who have claims against him in connection with CJV transactions will "suffer the most as a result of the dismissal of the complaint against them." (A-185.) Sloan appears to have concluded that if he is successful in collecting from anyone—including apparently the very brokerage defendants

of whom he is so solicitous—then the brokers should rejoice because Sloan would then have funds to satisfy the judgments these brokers might obtain against him. (A-187.)

Although Sloan attempts to create the impression that the Court below gave his fourth amended complaint inequitably short shrift, the record completely belies this assumption. From the time this complaint was served on the defendants in January, 1974 until the Court's decision of May 30, 1974, numerous defendants made motions to dismiss with respect thereto. The Court summarizes most of these motions in its decision. (SA-10).* Although he had failed to appear at the January 14, 1974 hearing on the motions to dismiss, Sloan was permitted to file two rather lengthy memoranda (entered on Docket on February 25, 1974 and April 10, 1974) in opposition to the motions and in support of the sufficiency of his amended complaint. (A-vi; A-viii). Sloan also made a motion for summary judgment and filed an affidavit in support thereof entered on March 20, 1974. (A-viii). All of these papers as well as defendants' motion papers were before the Court and were considered by Judge Bonsal before he rendered his decision dismissing the final amended complaint with prejudice as to the defendants herein joined.

In summary, Sloan filed two complaints, served but did not file a proposed amended complaint, and was given a final opportunity to frame an amended complaint which met the pleading requirements of the Federal Rules of Civil Procedure, which amended complaint was neither timely filed nor timely served. Sloan fully presented his reasons for failure to comply with Judge Bonsal's order and his substantive arguments in support of the adequacy

---

* Defendants Dow Jones & Company, Inc. and Muller & Co. made oral motions to dismiss the fourth amended complaint on January 14, 1974, which motions were entertained by the Court.

of his pleading. The Court below carefully considered all of Sloan's contentions and found them to be without merit. For the reasons stated hereinabove and in the Argument following it is respectfully submitted that the decision of the District Court was correct and should be affirmed in all respects.

## Argument

### I.

### THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN DISMISSING THE COMPLAINTS WITH PREJUDICE.

The question before this Court is whether there was an abuse of discretion by Judge Bonsal in dismissing the complaints. *Joseph Muller Corporation Zurich* v. *Societe Anonyme de Gerance et d'Armement,* 508 F.2d 814 (2d Cir. 1974); *Michelsen* v. *Moore-McCormack Lines, Inc.,* 429 F.2d 394 (2d Cir. 1970); *West* v. *Gilbert,* 361 F.2d 314 (2d Cir.), *cert. denied,* 385 U.S. 919 (1966). The patently frivolous confusion of arguments advanced by Sloan, based in substantial part on matters outside of the record, fall far short of establishing such an abuse. As stated in *In Re Josephson,* 218 F.2d 174, 182 (1st Cir. 1954), the discretionary action of a district court "cannot be set aside by a reviewing court unless it has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors."

The decision of Judge Bonsal reveals three substantial grounds for the dismissals—the filing of an amended complaint after the expiration of the time directed by the Court; the failure of the untimely complaint to comply with the specificity requirements of Rule 9(b), Fed. R. Civ. P.,



as interpreted in this Circuit, and the failure of the complaint to show any direct injury to Sloan.* While it is evident that when viewed collectively these grounds more than amply justify Judge Bonsal's decision, it is further submitted that each ground examined separately shows that the dismissals below were clearly within the proper exercise of the Court's discretion.

**A. Sloan failed to comply with an order of the Court.**

After having been afforded several opportunities to frame a proper complaint in this action, Sloan now seeks to characterize as an abuse of discretion the refusal of Judge Bonsal to accept a fourth insufficient complaint filed nineteen days after the time allotted by the Court. Apparently believing that there should be no limitation on his right to continually amend his pleadings and to bombard and harass defendants with further complaints, Sloan advances the unique assertion that he could not have failed to comply with an order of the Court, because there was no such order (Appellant's Brief pp. 34-36). Though Sloan admits that he was "told he would have twenty days to file an amended complaint" (Appellant's Brief p. 10), and that there was a "statement of Judge Bonsal directing Sloan to

---

* Sloan's brief, at page 43, states that the opinion below expresses the view that the doctrine of "unclean hands" precludes him from maintaining this action. Judge Bonsal does not hold that the doctrine provides a defense in this case. He points out that the amended complaint does not allege that Sloan was in any way directly injured by the alleged fraud. On the contrary, Sloan did not rely on the purportedly fraudulent misrepresentations but was admittedly aware of their alleged falsity from the beginning. Sloan apparently sold the shares of Canadian Javelin short in the hope that the alleged falsity would be exposed, causing a decrease in the cover price of the shares and resulting in a large profit to him. The opinion below recognizes that one who is aware of a fraud, although not relying upon it, and who trades in securities despite that fraud in the hope of reaping a profit from its exposure has no claim under the securities laws (SA-12).

file an amended complaint within twenty days'' (Appellant's Brief p. 32), Sloan contends now that the amended complaint could not be untimely because it was not ''ordered'' to be timely. The spurious argument thus goes, that unless there were a written ''order'' limiting his time to twenty days, there could not be a dismissal under Rule 41(b), Fed. R. Civ. P.*

The result of such a contention would, of course, be absurd. All rulings from the bench, all directions of judges and magistrates at pretrial conferences could be ignored by parties and their trial counsel as being mere nullities, for they would not qualify as ''orders''. In advancing this contention, however, Sloan loses sight of several factors, not the least important of which is that the oral directive of Judge Bonsal is the source of Sloan's right to amend his complaint in the first instance. Sloan cannot seriously contend that he could serve a fourth amended complaint without obtaining leave from the Court under Rule 15(a), Fed. R. Civ. In short, Sloan would have this Court find the directive of Judge Bonsal valid insofar as it granted leave for him to amend his complaint, but a nullity insofar as it placed any time limitation on that leave to amend.

A more basic flaw exists in this contention of Sloan, however. It has long been recognized that the power of a court to dismiss *sua sponte* for failure to obey its directions has ''generally been considered an inherent power, governed *not by any rule or statute,* but by the control necessarily vested in courts to manage their own affairs so as

---

* Defendants are baffled as to how Sloan could have been prejudiced by the lack of a written order. Being at the hearing, he was well aware of the Judge's direction. If anyone could complain about the oral leave to amend the complaint, it would be the defendants who were not present.

to achieve orderly and expeditious disposition of cases." *Link* v. *Wabash R. Co.*, 370 U.S. 626, 630 (1962) (emphasis added). Even assuming *arguendo* that Judge Bonsal's direction was not technically an "order" for purposes of Rule 41(b), Fed. R. Civ. P., because it was not memorialized in a writing, the inherent power to dismiss exists *independently* of Rule 41(b), and amply justifies the action of Judge Bonsal.

Furthermore, as the opinion below also holds that the complaints were insufficient under Rule 9(b), Fed. R. Civ. P., there is both actual and literal compliance with Rule 41(b), Fed. R. Civ. P., which authorizes dismissal for failure to comply with the Federal Rules of Civil Procedure as well as orders of the court.

**B. There was no error in the failure of the Court to grant additional time to file the final amended complaint or in dismissal of the amended complaint for untimeliness.**

Sloan, apparently forgetting that he instituted this litigation and again raising factors including telephone conversations outside of the record, seeks to find reversible error in the failure to receive an extension of time to file the fourth and final amended complaint, when it was purportedly inconvenient for him to comply with the direction of the Court. (Appellant's Brief pp. 32-33). The alleged basis of Sloan's inconvenience was the trial of *SEC* v. *Sloan*, 71 Civ. 2695 (S.D.N.Y.), a case in which Sloan had counsel until December 12, 1973. The trial was not commenced until the expiration of his time to file an amended complaint and should not serve as grounds for a finding that there was an abuse of discretion in the refusal to extend Sloan's time to file the fourth in the series of defective

complaints.* Were Sloan complaining that the District Court was arbitrary and capricious in failing ever to permit him to amend his complaint, defendants could understand his argument. However, as the record here indicates, Sloan was given several opportunities prior to this final chance to file amendments. It is clearly not an abuse of discretion to refuse to permit the late filing of an amended complaint where there have been two or three previous defective complaints. *Mooney* v. *Vitolo,* 435 F.2d 838 (2d Cir. 1970). As stated in *Shall* v. *Henry,* 211 F.2d 226, 231 (7th Cir. 1954):

> "In view of the many amendments to the complaint permitted by the court and the voluminous pleadings filed as a result, even though the right to amend is to be construed liberally, we think the court did not abuse its discretion in denying at the time of judgment application to amend still further. There must be an end sometime to applications to amend."

In view of the prior amendments of the complaint, it is apparent that when Judge Bonsal directed that the final amendment must be filed within twenty days, he most properly imposed a reasonable condition under Rule 15, Fed. R. Civ. P., upon the leave granted to Sloan. As stated in *Rossi* v. *McClosky & Co.,* 149 F. Supp. 638, 641 (E.D. Pa. 1957):

> "Leave of the Court, freely given when justice so requires, is a condition precedent to the filing of a second amended complaint, absent the written consent of the adverse parties. To such leave, the Court may attach reasonable conditions . . . The plaintiffs failed to comply with the reasonable condition here imposed, that the amended pleading be submitted within twenty days, and for such failure to comply with an Order of Court, the defendant may move under Fed. R. Civ. P. 41(b), for dismissal of the action."

* Sloan's brief, at pages 32-33, admits that Judge Bonsal "was perhaps not aware of this conflict" when he directed that Sloan file an amended complaint within twenty days. Obviously Sloan was aware of the forthcoming trial and could have so advised Judge Bonsal on November 19, 1973, but apparently chose not to.



Considering all of the above, the repeated amendments, the deficiencies in all of the complaints and the ultimate failure of Sloan to adhere to a reasonable condition imposed under Rule 15, Fed. R. Civ. P., the dismissals of the complaints with prejudice were not only within the sound discretion of Judge Bonsal but were the most proper exercise of that power. Sloan should not be afforded any further special indulgence because of his *pro se* status. *Kamsler* v. *H. A. Seinscheimer Co.,* 347 F.2d 740 (7th Cir.), *cert. denied,* 382 U.S. 837 (1965).

**C. Sloan's contention that there were no valid motions to dismiss the complaints is inapposite.**

Sloan seeks to impress upon this Court that there were no motions directed at the untimeliness of the amended complaint. (Appellant's Brief pp. 25-29). However, Sloan admits that "at oral argument of January 14, 1974 several attorneys objected to the filing of the amended complaint" (Appellant's Brief p. 28). Sloan further recognizes that he had received notice of the hearing to be held on January 14, 1975 (Appellant's Brief p. 24), at least in Sloan's words "technically", and, in fact, sent a representative to attend same. As the record indicates, several defendants moved at this hearing for dismissal of the complaint because of untimeliness, failure to state a cause of action and other grounds (A-126-133).

Under Rule 7(b), Fed. R. Civ. P., these motions, being made at a hearing, were not required to be in writing. As was stated in *Alger* v. *Hayes*, 452 F.2d 841, 843 (8th Cir. 1972):

> "The type of 'hearing' at which there is no need for reducing a motion to writing is one in which the proceedings are recorded."

There was a recording of this hearing and it is part of the record herein. (A-126). Sloan's contention that he was unaware that such a record was being made is refuted by the presence of his representative at that hearing. Furthermore, the docket sheet clearly reveals several motions to dismiss which were in writing and upon notice (A-iv) and to which Sloan chose not to respond. Indeed Sloan did not even bother to return to New York. Moreover, as it is apparent that the amended complaint was untimely and in disobedience of the direction of the Court, the motions to dismiss were not even necessary. The trial court has the inherent power to dismiss, *sua sponte,* where there has been such a disobedience. This discretionary power was most suitably exercised here. *Agnew* v. *Moody,* 330 F.2d 868 (9th Cir.), *cert. denied* 379 U.S. 867 (1964). "This power must be exercised in appropriate situations to protect the integrity of the Court and its orders." *U.S.N. Co.* v. *American Express Co.,* 55 F.R.D. 31, 35 (E.D. Pa. 1972).

The amended complaint was not only untimely but also failed to comply with the requirements of Rule 9(b), Fed. R. Civ. P. (as more fully demonstrated *infra*). The dismissal with prejudice was thus clearly warranted, particularly when it is considered that this amended complaint followed three prior opportunities Sloan had to frame a proper pleading. *Feinberg* v. *Leach,* 243 F.2d 64 (5th Cir. 1957); *Lammon* v. *City and County of San Francisco,* 64 F. Supp. 154 (N.D. Calif. 1946).

**D. Prejudice resulted to the defendants from the course of the proceedings below.**

Sloan's contention that the defendants were not subjected to considerable expense and time consuming work because of the defective and untimely pleadings is belied by the record before this Court. Almost two years have elapsed since the filing of the first complaint. A perusal of the docket sheets (A-iv–xiii) reveals approximately 50 separate entries of defendants' answers, motions and affidavits prior to the decision of Judge Bonsal, all the product of innumerable collective hours of counsels' work. Defendants cannot agree that the assumed constitutional obligation of defending frivolous lawsuits (Appellant's Brief pp. 31-32) should subject them to continued harassment and expense by requiring continued response to untimely and blatantly defective pleadings.

Furthermore, when there is a failure to prosecute or a failure to adhere to reasonable time limitations imposed by the Court, the focus is not solely directed at the prejudice to the defendants. Sloan's failure to file timely the complaint as directed, and his inability, after repeated attempts, to comply with Rule 9(b), Fed. R. Civ. P., justify dismissal with prejudice, even absent a showing of harm to defendants. *Messenger* v. *United States,* 231 F.2d 328 (2d Cir. 1956); *Klein* v. *Spear, Leeds and Kellogg,* 65 F.R.D. 406 (S.D.N.Y. 1974).

**E. Sloan was afforded ample opportunity to controvert defendants' motions to dismiss.**

In his brief, Sloan contends that there were several procedural deficiencies pertaining to the motions to dismiss the complaints—*viz,* some motions were oral, some written motions were filed late, and Sloan was not able to secure an adjournment to be present on the return date

of January 14, 1974. Had Judge Bonsal summarily dismissed the complaints on January 14, 1975, perhaps Sloan would have been denied a proper opportunity to present his arguments. However, as the record clearly indicates Sloan did in fact present opposition to the dismissal motions.

It must be noted that Judge Bonsal did not decide the January 14, 1974 motions until May 30th of that year. In the interim Sloan presented various affidavits and memoranda responsive to the defendants' motions. The docket sheet shows that on February 25, 1974, Sloan filed a memorandum consisting of 19 pages in opposition to various motions to dismiss. On February 27, 1974, Sloan filed his papers for summary judgment. On April 10, 1974, Sloan filed a further memorandum consisting of 12 pages in opposition to motions to dismiss. It is thus apparent that even assuming *arguendo* that there were procedural irregularities in the dismissal motions, they resulted in no prejudicial effect, as Sloan was able to respond to defendants' contentions prior to the decision of Judge Bonsal. Judge Bonsal was able to review the arguments of both sides and, in view of the time involved in rendering his decision, must have given considerable and careful thought and attention to the matter.

Moreover, Sloan, in his motion in June of 1974 for leave to amend and to "reverse" the decision of Judge Bonsal, again presented his arguments to the court at length.

Thus, the course of proceedings below in no way interferred with Sloan's right to refute applications of the defendants. It is apparent that Judge Bonsal was given a full and fair record upon which to base his determination.

## II.

## SLOAN HAS FAILED TO STATE A CLAIM UNDER THE ANTIFRAUD PROVISIONS OF THE SECURITIES LAWS

### A. Sloan fails to state a claim for relief with the specificity required by Rule 9(b) of the Federal Rules of Civil Procedure.

A complaint alleging a violation of the antifraud provisions of the securities laws* sounds in fraud and is subject to the particularity requirements of Rule 9(b) of the Federal Rules of Civil Procedure which requires that "[i]n all averments of fraud or mistake the circumstances constituting fraud or mistake shall be stated with particularity." In his opinion below, Judge Bonsal held that the amended complaint of December 29, 1973 failed to meet the requirements of the rule in at least three important respects. The judge found that plaintiff failed to specify that he relied to his detriment on the alleged false and misleading statements, that his injuries were caused in fact by defendants' alleged fraudulent activities and that the alleged fraudulent statements were made in connection with a purchase or sale of a security by him. This holding is clearly correct.

In a number of recent decisions this Court has reiterated the position that the particularity requirement must be met in securities fraud litigation as well as in cases involving common law fraud. *Felton* v. *Walston & Co.*, 508 F.2d 577 (2d Cir. 1974); *Segal* v. *Gordon*, 467 F.2d 602 (2d Cir. 1972); *Shemtob* v. *Shearson, Hammill & Co.*, 448 F.2d 442 (2d Cir. 1971). This principle was recognized and

---

* Securities Act of 1933, 15 U.S.C. §§ 77a-77aa; Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78jj.

applied by the District Court in *Schonholtz* v. *American Stock Exchange Inc.*, 376 F. Supp. 1089 (S.D.N.Y. 1974).

> "Both Rule 9(b), Federal Rules of Civil Procedure, and decisions of this Circuit require that the circumstances constituting a § 10(b) claim be stated with particularity and that mere conclusory allegations of fraud are insufficient to state a § 10(b) claim." *Id.* at 1091.

In *Schonholtz, supra,* plaintiff was a short seller who alleged that defendants impliedly represented to the public that there was an adequate floating supply of the stock plaintiff was selling. Plaintiff relied on this representation, which turned out to be false. Plaintiff's complaint was dismissed on the grounds that it did not state any recognizable securities fraud with sufficient particularity. *See also Lewis* v. *Varnes,* 368 F. Supp. 45 (S.D.N.Y. 1974) (complaint alleging that defendant possessed inside information which he unfairly used did not meet specificity requirement) and *Matheson* v. *White Weld & Co.,* 53 F.R.D. 450 (S.D.N.Y. 1971) (complaint must allege facts of fraud or scienter; negligence alone is insufficient).

Sloan asserts claims under the antifraud provisions of the securities laws based upon alleged misrepresentations. He claims in his brief (p. 41 *et seq.*) that he need not prove reliance upon such alleged misrepresentations but only that his injuries were in fact caused by them. Sloan thus refuses to give information on the times of his purchases and sales, his reading of and reliance on various articles he cites, and his actual reliance on the statements or actions of individual brokers.

In his final amended complaint, Sloan merely sets forth a series of alleged fraudulent misrepresentations without any particularization of the circumstances surrounding such



fraudulent acts or his reliance thereon. For instance, he states with regard to his securities fraud claim (Count II) that

> "All of these statements and the numeous other statements and press releases issued by Javelin and its officers and subsidiaries were false, misleading, untrue and deceptive." (A-83, ¶ 70).

*See also,* ¶¶ 80-91, 95, 125, 132, 144. The specificity standard for a § 10(b) action has been set forth in *Matheson, supra* at 452:

> "We have now been instructed that claims under Section 10(b) or Rule 10b-5 require for sufficiency 'allegations of fact amounting to scienter, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud. It is insufficient to allege mere negligence.'"

More recently, in *Felton* v. *Walston & Co.,* 508 F.2d 577 (2d Cir. 1974), this Court found that plaintiff's allegation that defendant sold "worthless" companies to a corporation and "falsely and deceptively declared to the investing public" that the purchase of the companies "was a major viable acquisition," was conclusory and not sufficiently particularized. This Court thus demands a very specific allegation of how, when and where the fraud was committed and of a causal relation between the fraud and plaintiff's alleged injuries.

**B. Sloan lacks standing to sue under the *Birnbaum* Rule.**

The rule of this Circuit limits a plaintiff in a Rule 10b-5 action to an actual purchaser or seller of securities. *Birnbaum* v. *Newport Steel Corp.,* 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952).

This rule was recently adopted by the United States Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 43 U.S.L.W. 4707 (June 9, 1975). The Court said that the *Birnbaum* rule permits exclusion prior to trial of plaintiffs who were not themselves purchasers or sellers of the stock in question. The Court noted that:

> "The fact of purchase of stock and the fact of sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, so that failure to qualify under the *Birnbaum* rule is a matter that can normally be established by the defendant . . . on a motion to dismiss." *Id.* at 4713.

Sloan has continually refused to give information and documentation which establishes that he was a purchaser or seller under the *Birnbaum/Blue Chip* rule. Without such information, Sloan has no standing to bring this case under § 10b. Despite the fact that he has served or filed four complaints, Sloan has not alleged that he was a purchaser or seller during the time in question. He has merely alleged that he was "short" in Canadian Javelin stock. Essentially, Sloan had already borrowed stock from an owner and presumably had sold it*, but did not buy or sell in connection with the alleged fraud.

**C. There is no allegation in the complaint that Sloan relied to his detriment on the alleged false and misleading statements and reports.**

In the context of a complaint alleging affirmative representations by defendants, a plaintiff must prove his reliance** upon the alleged misrepresentations to assert a

---

* For a definition of selling short *see, e.g.*, Merrill Lynch, Pierce Fenner & Smith, Inc. v. Bocock, 247 F.Supp. 373, 374 (S.D. Tex. 1965).

** For a general discussion of reliance in 10b actions, *see* Note, The Reliance Requirement in Private Actions Under SEC Rule 10b-5, 88 Harv. L. Rev. 584 (1975).

claim for damages. *See, e.g., Titan Group, Inc.* v. *Faggen*, Fed. Sec. L. Rep. ¶ 95,042 (2d Cir. April 1, 1975); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974); *Shapiro* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 240 (2d Cir. 1974). The reliance test was set forth in *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965):

> "The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact."

Sloan did not and could not meet the requirements of this test. According to paragraph 172 of the amended complaint dated December 29, 1973, Sloan was a short seller of CJV (A-104). An examination of this complaint shows no allegation of reliance. Nor could there be any such allegation because Sloan admits that he believed defendants' statements were false from the start.

In paragraph 105 of the December 29 complaint, Sloan states that he telephoned the S.E.C. and the American Stock Exchange on July 5, 1973, to report information as to CJV. (A-91) He states that "he knew these individuals because he spoke to them on many occasions about Javelin prior to that time." (A-91) Thus, prior to July 5, the day Sloan called Panama to check on certain published information, Sloan was already aware of Javelin's allegedly shaky position and was concerned enough to be in contact with both the S.E.C. and the American Stock Exchange. He in fact was selling short because he believed that the company's position was weak and its stock would go down. He certainly would not have behaved any differently if defendants had refrained from making the alleged misrepresenta-

tions. At no time did he act in reliance on the so-called "false" statements. Had he done so he would have been purchasing stock with the hope of further increases in price rather than voluntarily placing himself in a short position, which he obviously hoped would permit him to profit personally from the very deceptions of which he now complains.

**D. Sloan cannot escape the necessity of alleging reliance by arguing that his injury was caused in fact by defendants' conduct.**

In *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972), the Supreme Court eliminated proof of reliance as a prerequisite to recovery in securities fraud cases involving nondisclosure of insider information. Rather, a determination of materiality creates an inference of reliance. In *Affiliated Ute* plaintiffs were holders of stock deposited in a bank. Defendants, employees of the bank, arranged for the sale of the stock. The latter had failed to disclose to plaintiffs facts regarding the bank's and the employees' position as market makers and facts regarding the true value of the stock.

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. . . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." *Id.* at 153-54.

In *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 495 F.2d 228 (2d Cir. 1974), this Court applied the causation in fact test to investors who purchased securities without certain information which was then in the hands

of the managing underwriters of the bond issue. This Court held that plaintiff-purchasers were injured and the injury was caused in fact by defendant's nondisclosure of material facts. The Court concluded that

> "[t]he requisite element of causation in fact has been established by the . . . withholding . . . of material inside information . . . such information being clearly material in the sense that plaintiffs as reasonable investors might have considered it important in making their decision to purchase Douglas stock." *Id.* at 240

*Affiliated Ute* and *Shapiro* decisively limit their holdings to cases involving nondisclosure of material inside information. The instant case does not involve "nondisclosure" but rather alleged misrepresentations of material facts. Thus, in this Circuit it is beyond question that Sloan must plead and prove reliance on these alleged misrepresentations. *Titan Group, Inc.* v. *Faggen, supra.*

The requirement that plaintiff allege reliance in a 10(b) action has also been eliminated in this Circuit in one other situation—when plaintiff alleges a comprehensive scheme to defraud.

> "[a] showing of reliance is not required where a comprehensive scheme to defraud which includes not only omissions and misrepresentations, but substantial collateral conduct as well, is alleged. Not every violation of the antifraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures'. Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws." *Competitive Association Inc.* v. *Laventhol Krekstein, Horwath & Horwath,* 516 F.2d 811, 814 (2d Cir. 1975).

In that case plaintiff hired an investment advisor and his company as one of its portfolio managers. Plaintiff investigated his potential advisor, in part by reviewing the financial statements of a private investment fund managed by the advisor and his company. Plaintiff alleged that defendant—accounting firm had knowingly and with intent to defaud certified false and misleading financial statements, failed to disclose the true financial condition of the advisor, and received pay-offs in return for its certification. This court held that in view of this alleged "elaborate scheme to defraud" plaintiff was not required to show direct reliance on defendant's financial statements.

In the instant action Sloan has never alleged that the brokers and publishers were involved in any comprehensive scheme to defraud him. His case is really one of alleged misrepresentations. Thus by the standard of *Competitive Association, supra,* this action would not be governed by the new causation in fact test. Sloan must therefore allege and prove his reliance on the actions of defendants other than CJV. Since Sloan has not done so he has failed to state a cause of action against the peripheral defendants herein, and the opinion of the District Court should be affirmed.

**E. Sloan fails to allege scienter on the part of defendants.**

In § 10(b) and § 17 actions an allegation of mere negligence is insufficient. In *Shemtob* v. *Shearson, Hammill & Co.,* 448 F.2d 442 (2d Cir. 1971), this Court held that plaintiff must allege defendant's "scienter, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud." *Id.* at 445. Similarly, in *Cohen* v. *Franchard Corp.,* 478 F.2d 115 (2d Cir.), *cert. denied,* 414 U.S. 857 (1973), this Court upheld a verdict

for defendants in which Judge MacMahon had given the following charge:

> "Guilty knowledge is the key to your decision in this case. The plaintiffs must establish that the defendant whom you are considering had knowledge and intended to defraud these plaintiffs, or that he acted in reckless disregard for the truth, or that he knowingly used a device, scheme, or artifice to defraud." *Id.* at 123.

The scienter requirement could only be met by an allegation that each and every defendant fraudulently or at least recklessly disregarded Sloan's interest. This allegation would have to be made with the required specificity.

With the exception, perhaps, of the defendants directly related to CJV, Sloan has failed to specifically allege any kind of scienter in his complaint of December 29, 1973. In fact, Sloan acknowledged in his complaint that many of the defendants "may possibly be deemed the victims of a fraud perpetrated." (A-105, ¶ 181). In his affidavit of June 4, 1975 (A-184 *et seq.*) Sloan defends the broker-defendants claiming they "will suffer the most as a result of this decision" to dismiss the complaint. He says further that not allowing him to sue "extinguished any possibility that the brokers in question might recover" the money Sloan owes them. (A-185) In this affidavit Sloan convincingly shows that he believes he has a legitimate action only against CJV and those directly related to it. He further reveals that as to the broker, publishing and other peripheral defendants scienter was neither pleaded nor is it provable.

## III.

### SLOAN'S COMPLAINT AGAINST EDWARDS & HANLY HAS BEEN FULLY ADJUDICATED IN THE STATE COURTS.

In his brief, Sloan recognizes that his claim against the defendant Edwards & Hanly is "virtually identical" to a counterclaim made by Sloan in the case of *Edwards & Hanly* v. *Samuel H. Sloan,* pending in the New York State Supreme Court (Appellant's Brief pp. 20-21). Sloan further correctly alleges that on May 27, 1975, in an order (A-366-67) accompanied by a two-page decision (A-368-69), the Appellate Division modified the decision of the trial court in the foregoing state action, by dismissing the counterclaim of Sloan and adjudging that Edwards & Hanly recover from Sloan the sum of $5,662.50 (Appellant's Brief pp. 15-17). Thus, Sloan recognizes that unless this Court should enjoin completed state court proceedings, the matters which Sloan seeks to litigate in the federal court are *res judicata* by reason of the state court's decision (Appellant's Brief pp. 63-64).

Sloan therefore argues that this Court should enjoin Edwards & Hanly's state court action and, presumably, should further declare the substantial proceedings to date in the state court to be a nullity. Such a contention is frivolous.

The only basis upon which Sloan seeks such novel relief is that he contends that the state court ruled upon questions of federal securities laws over which the federal courts allegedly have exclusive jurisdiction. Initially, it should be noted that Sloan's contention that the state court ruled on questions of federal securities laws is incorrect. Edwards & Hanly sued Sloan for simple breach of brokerage contract and Sloan counterclaimed for conver-

sion and breach of contract which are clearly state law claims. The basis for Edwards & Hanly's claim was that Sloan, by engaging in short-selling, was admittedly unable to deliver the shares he sold within the time provided by applicable law. Thus, Edwards & Hanly's claim was not premised upon the legality of short-selling, but rather upon the failure to deliver the shares.

Sloan alleges (Appellant's Brief p. 62) that the Appellate Division was adjudicating a matter of federal securities law by determining that Sloan engaged in short-selling as prohibited in the account which Sloan maintained with Edwards & Hanly. Sloan, however, misquotes the omnibus account agreement upon which the Appellate Division ruling was premised. That part of the agreement which the Appellate Division deemed relevant states:

> "It is understood and agreed that any transaction which the undersigned advises you is made by or any security which the undersigned advises you is carried for, the undersigned with you for its own account or for the account of anyone other than its aforesaid customers, will be entered in a separate account or accounts with you and will be margined to the full extent that you may from time to time require, and that transactions in such separate account or accounts shall not entitle you to any lien on any of the securities in the aforesaid special omnibus account or on any securities which the undersigned advises you are carried for the account of customers of the undersigned."

Since Sloan did not, in accordance with this agreement, advise Edwards & Hanly that he was selling short for his own account as a customer, or establish a separate customers' account for such short-selling, Sloan clearly vio-

lated a contractual provision which has nothing to do with any violation of the federal securities laws.

Moreover, it is established that the state courts may rule upon questions involving the federal securities laws when the questions are raised by way of a defense. *Aetna State Bank* v. *Altheimer*, 430 F.2d 750, 754 (7th Cir. 1970). Thus, even if Sloan wishes to turn his case into one involving the federal securities laws, meritless as such a position might be, it is apparent that there is still no basis for this Court disturbing the ruling of the Appellate Division, First Department.

It is, thus, apparent that the cases of *Vernitron Corp.* v. *Benjamin*, 440 F.2d 105 (2d Cir.), *cert. denied*, 402 U.S. 987 (1971), and *Jennings* v. *Boenning & Co.*, 482 F.2d 1128 (3d Cir.), *cert. denied*, 414 U.S. 1025 (1973), clearly control.

In view of the foregoing, all of Sloan's complaints against Edwards & Hanly have been adjudicated in the New York State Courts. Sloan has, in fact, appealed to the New York State Court of Appeals from the order of the Appellate Division (Appellant's Brief p. 17). Thus, there is no basis for permitting Sloan to litigate against Edwards & Hanly in the federal court.

## CONCLUSION

By reason of the foregoing, the decision, order and judgment of the District Court should be affirmed in all respects.

Dated: New York, New York
October 10, 1975

Respectfully submitted,

PATTERSON, BELKNAP & WEBB
*Attorneys for Dow Jones & Company, Inc., Stewart Pinkerton*
30 Rockefeller Plaza
New York, New York 10020
(212) 541-4000

*Of Counsel*
MARGUERITE B. FILSON

STROOCK & STROOCK & LAVAN
*Attorneys for Loeb, Rhoades & Co.*
61 Broadway
New York, New York 10004
(212) 425-5200

*Of Counsel*
LAWRENCE HANDELSMAN

SULLIVAN & CROMWELL
*Attorneys for Bache & Co., Inc., The Miami Herald*
48 Wall Street
New York, New York 10005
(212) 952-8100

*Of Counsel*
MARVIN SCHWARTZ
PAMELA S. DWYER

LEONARD TOBOROFF, Esq.
*Attorneys for Chartered New England Corp., F.S. Moseley Estabrook, Inc.*
17 East 63rd Street
New York, New York 10021
(212) 838-2323

*Of Counsel*
MICHAEL SHANNON

DELSON & GORDON
*Attorneys for Edwards & Hanly, Arthur Foote, Robert Della, Raymond Aronson*
230 Park Avenue
New York, New York 10017
(212) 686-8030

*Of Counsel*
EVAN L. GORDON

LORD, DAY & LORD
*Attorneys for American Stock Exchange, Stephen L. Gerard*
25 Broadway
New York, New York 10004
(212) 344-8480

OLITT, FRIEDBERG & KAGEL
*Attorneys for Muller & Co.*
200 Park Avenue
New York, New York 10017
(212) 661-8686

SATTERLEE & STEPHENS
*Attorneys for Watts, Griffis & McQuad*
277 Park Avenue
New York, New York 10017
(212) 826-6200

SILBERFELD, DANZIGER & BANGSER
*Attorneys for Miller Freeman Publications, Inc.*
230 Park Avenue
New York, New York 10017
(212) 889-8400

## CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing instrument was served upon the attorneys of record of all parties to the above cause in accordance with Rule 5, Federal Rules of Civil Procedure, on this 10th day of October, 1975

SULLIVAN & CROMWELL

By George A. Schuyler